San Diego City Attorney
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NEWS RELEASE

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SEC SETTLEMENT WITH CITY OF SAN DIEGO CAPS MARATHON EFFORT BY THE CITY ATTORNEY'S OFFICE

San Diego, CA—The fraudulent municipal bond offerings settlement announced today between the United States Securities and Exchange Commission (SEC) and the City of San Diego was first advocated by City Attorney Michael Aguirre in February 2005, less than three months after taking office as San Diego City Attorney.

In order to settle the SEC's action against it, the City has agreed to cease-and-desist violating securities laws in the future issuance of municipal bonds and will retain an independent consultant to monitor compliance with its disclosure obligations.

Unanimously approved in closed session by the City Council on October 24, 2006, the 22-page agreement effectively ends the SEC's investigation into the City as an entity. The SEC will still be able to pursue separate enforcement action against any individuals who may have committed wrongdoing in connection with the City's financial disclosure practices.

The SEC began its investigation of the City in February 2004. It was triggered after allegations of bond disclosure irregularities were confirmed by City officials on January 27, 2004.

"The path we took put the City's interest first and now allows us to begin repairing our financial system in order to access the municipal bond markets," said City Attorney Michael Aguirre. "I would like to commend Mayor Jerry Sanders and our outside legal counsel John Hartigan of the law firm Morgan Lewis and Bockius who were integral members of the City's negotiating team."

In imposing sanctions against the City, the SEC concluded that the City of San Diego violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 which prohibit misrepresentations or omissions of material facts in the offer or sale of securities.

While not levying a fine, the SEC's cease-and-desist order reprimands the City for not disclosing to investors the massive, intentional underfunding of its employee pension and health care plans in connection with the offer and sale in 2002 and 2003 of over $260 million in five separate municipal bond offerings.

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The City also did not report the pension and healthcare plan underfunding in "continuing disclosure" documents related to $2.29 billion in outstanding bonds for the purpose of updating investors on the state of the City's finances.

The SEC settlement requires the City to hire an independent consultant for a three-year period to:

a) conduct annual reviews of the City's policies, procedures, and internal controls regarding its disclosures for offerings;
b) make recommendations concerning these policies, procedures and internal controls; and
c) assess whether the City is complying with its policies, procedures and internal controls.

The settlement also requires the City to implement all recommendations made by the independent consultant, or the City may suggest alternative methods provided that the Mayor and City Attorney certify in writing to the SEC that the alternative method will achieve the same objective.

Focusing on the City's prior administration, the SEC concluded that the City of San Diego, through its officials, acted with scienter, which is "a mental state embracing intent to deceive, manipulate or defraud."

Two criminal investigations related to the City's underfunding of its pension system in exchange for increased employee benefits are ongoing:

a) On January 6, 2006, a federal grand jury indicted San Diego City Employees' Retirement System (SDCERS) Board Counsel Lorraine Chapin, Retirement Administrator Lawrence Grissom, and three former trustees Cathy Lexin, Terri Webster, and firefighter union president Ron Saathoff. They were charged with multiple felonies, including conspiracy, wire and mail fraud and aiding and abetting. The indictment said the defendants conspired to illegally obtain enhanced retirement benefits for themselves in exchange for allowing the City to underfund the employees' pension system.

b) On May 17, 2005 the District Attorney's Office filed felony charges against six former SDCERS board members (Cathy Lexin, Ronald Saathoff, Sharon Wilkinson, Mary Vattimo and Terri Webster) and one current board member (John Torres). Ronald Saathoff, John A. Torres, Sharon Wilkinson, Mary Vattimo, and Terri Webster have each been charged with three felony counts of Government Code Section 1090 which states that "city officers or employees shall not be financially interested in any contract made by them in their official capacity or by anybody or board of which they are members." Cathy Lexin has been charged with two felony counts.

SEC SETTLEMENT TIMELINE:

February 22, 2005

Less than three months into his administration, City Attorney Michael Aguirre first raises the issue of negotiating a settlement with the SEC on behalf of the City of San Diego. The request is contained in a memorandum to Mayor Dick Murphy and the City Council, outlining the City Attorney's eight point legal action plan to address the City's financial condition. The Mayor and City Council did not act on this request.

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SEC SETTLEMENT TIMELINE:

August 16, 2005

Six months after the initial request, and shortly after the resignations of Mayor Dick Murphy and Councilmembers Ralph Inzunza and Michael Zucchet, San Diego City Attorney Michael Aguirre again requests the City Council to authorize him to enter into settlement negotiations with the SEC. He continues to advocate the position that the SEC should settle with the City separately, apart from any City officials who may have committed wrongdoing.

The request was contained in a memorandum to Acting Mayor Toni Atkins and the remaining 6 City Councilmembers. The Acting Mayor and City Council did not act on this request.

The City Attorney's Office begins drafting an SEC settlement agreement. The team includes Chief Deputy City Attorney Mark Blake and outside bond disclosure consul John McNally of the law firm Hawkins, Delafield & Wood.

August 29, 2005

National newspaper headlines reveal that the global accounting firm KPMG, which is also the City's outside auditor, has settled separately with the SEC related to its scheme to market illegal tax shelters. Individual company officials will settle any acts of wrongdoing with the SEC separately.

City Attorney Michael Aguirre issues a news release the same day pointing out that the SEC's settlement with KPMG is the same model that he is proposing the City negotiate with the SEC. Individual City officials would resolve any personal wrongdoing with the SEC separately. Again, he urges the City Council to allow him to pursue a settlement agreement with the SEC.

September 1, 2005

The City hires outside legal counsel, Morgan Lewis & Bockius, to represent the City before the SEC. The firm's lead lawyer in San Diego will be John Hartigan, a former assistant director of enforcement for the SEC. City Attorney Michael Aguirre pledges to work cooperatively with Hartigan in pursing the settlement agreement with the SEC.

The City Attorney's Office completes its draft of a settlement agreement with the SEC.

September 20, 2005

The City Attorney calls on Acting Mayor Toni Atkins and City Council to discuss the SEC draft settlement he has prepared in open session. The City Attorney publicly releases his proposed SEC draft settlement after the City Council agrees to hear the matter on September 27th.

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SEC SETTLEMENT TIMELINE:

September 27, 2005

In a special council meeting, the City Council gives the go-ahead for the City Attorney to begin negotiations with the SEC that could bring to a close the federal agency's investigation of the City's securities disclosure practices.

The draft settlement agreement, which separates the City from the issue of any alleged wrongdoing by City officials, recognizes remedial steps that the City has already taken and calls for additional reforms to be supervised by the SEC. If the SEC accepts the City Attorney's proposal, the City Council must approve the settlement.

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The City Attorney attended several negotiating sessions with SEC officials in Los Angeles to finalize the consent decree.

The proposal is reviewed three times by the City Council in closed session and unanimously approved on October 24, 2006.

The SEC approved the fraudulent municipal bond offerings settlement agreement with the City of San Diego on November 14, 2006 and was publicly announced by both agencies.

To view the November 14, 2006 SEC settlement, visit www.sandiegocityattorney.org, click "Significant Reports and Legal Documents."

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